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In The Supreme Court of the United States

DURA PHARMACEUTICALS, INC., *et al.*,

Petitioners,

v.

MICHAEL BROUDO, *et al.*,

Respondents.

On Writ Of Certiorari To The United States Court Of Appeals For The Ninth Circuit

BRIEF FOR TECHNOLOGY NETWORK AS *AMICUS CURIAE* IN SUPPORT OF PETITIONERS

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INTEREST OF THE *AMICUS CURIAE*[1]

Technology Network ("TechNet") is a network of Chief Executive Officers and senior partners of more than 150 companies in the information technology, biotechnology, venture capital, investment banking and legal industries. The association is organized to promote the growth of the technology industry and the economy by building long-term relationships among technology leaders. The majority of TechNet's members lead companies capitalized through publicly traded shares on the Nation's major stock exchanges. As members and investors in the technology and biotechnology industries, TechNet's members represent the leading edge of developing, manufacturing, and marketing emerging technologies.

The question presented by this case – the proper standard for pleading and proving "loss causation" in securities fraud cases – is an issue of recurring importance for members and investors in the emerging technology industries. Companies in these industries rely heavily on public capital investments to develop new ideas, many of which may never become viable in the marketplace. These companies' stock prices are often highly volatile, as the market potential of their emerging technologies waxes and wanes.

Due to the volatility of their stock, technology companies are frequent targets of private securities litigation,

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[1] Pursuant to this Court's Rule 37.6, *amicus* TechNet states that no counsel for any party authored this brief in whole or in part, and no person or entity made a monetary contribution to the preparation or submission of the brief. Pursuant to Rule 37.3(a), TechNet received permission to file this brief from both parties to this matter. A copy of each party's notice of consent is on file with the Clerk of the Court.

and such litigation is therefore of special concern. Congress recognized this concern when it enacted the Private Securities Litigation Reform Act of 1995 ("PSLRA")[2] to combat the high cost of frivolous securities litigation. 141 CONG. REC. H2763 (1995) (statement of Rep. Cox) ("High-tech and biotech companies have paid 40 percent of the costs of strike suit settlements[.]"). This concern remains unabated; even after Congress passed the PSLRA, companies in the technology industries remain the target of over 40% of all private securities litigation. Michael A. Perino, *Did the Private Securities Litigation Reform Act Work?*, 2003:4 U. ILL. L. REV. 913, 959. Because of the vital concern its members have for the issue presented in this matter, TechNet files this *amicus curiae* brief in support of Petitioners.

INTRODUCTION

The Ninth Circuit ruled in this case that plaintiffs in private securities litigation meet the standard for pleading loss causation by alleging that the price of the stock at issue was inflated on the date of purchase. This ruling improperly limits the ability of the district courts to weed out strike suits in which plaintiffs cannot plead a causal link between an alleged fraud and a decline in the price of the stock. As a result, the ruling subjects technology and other companies whose stock prices are inherently volatile to the burden and expense of unmeritorious litigation,

[2] Private Securities Litigation Reform Act, Pub. L. No. 104-67, 109 Stat. 737 (1995).

and, by so doing, contravenes the expressed intent of Congress in enacting the PSLRA.

REASONS FOR OVERTURNING THE RULING

1. THE NINTH CIRCUIT'S STANDARD FOR PLEADING LOSS CAUSATION UNDULY CURTAILS THE DISTRICT COURTS' ABILITY TO DISMISS UNMERITORIOUS CASES

The PSLRA confirms that loss causation is a required element of a claim for securities fraud. *See* 15 U.S.C. § 78u-4(b)(4). As courts, including the Ninth Circuit, have made clear, two types of causation are required for such claims: "transaction causation, that the violations in question caused the plaintiff to engage in the transaction, and loss causation, that the misrepresentations or omissions caused the harm." *Binder v. Gillespie*, 184 F.3d 1059, 1065 (9th Cir. 1999) (quoting *McGonigle v. Combs*, 968 F.2d 810, 820 (9th Cir. 1992)); *see also, e.g., Emergent Capital Inv. Mgt., LLC v. Stonepath Group, Inc.*, 343 F.3d 189, 196-97 (2d Cir. 2003); *Robbins v. Koger Props., Inc.*, 116 F.3d 1441, 1446, 1447 (11th Cir. 1997).

As the Ninth Circuit itself has acknowledged, "the loss causation requirement limits the ability of plaintiffs to recover for losses sustained on the basis of factors unrelated to any misrepresentation or fraud." *Ambassador Hotel Co. v. Wei-Chuan Inv.*, 189 F.3d 1017, 1027 (9th Cir. 1999). Other courts concur. *See, e.g., Emergent Capital*, 343 F.3d at 197 ("[I]f the loss was caused by an intervening event, like a general fall in the price of Internet stocks, the chain of causation will not have been established."); *Gasner v. Bd. of Supervisors*, 103 F.3d 351, 360 (4th Cir.

1996) (loss causation not established where intervening causes, as opposed to misrepresentation, resulted in failure of venture); *Bastian v. Petren Res. Corp.*, 892 F.2d 680, 685 (7th Cir. 1990) (loss causation not established where the plaintiffs' investments declined due to a general decline in industry, rather than as a result of the alleged fraud).

In the Ninth Circuit, however, this limitation is effectively waived at the pleading stage in fraud on the market cases. According to the Ninth Circuit, plaintiffs adequately plead loss causation simply by alleging that "the price *on the date of purchase* was inflated because of the misrepresentation." *Broudo v. Dura Pharms.*, 339 F.3d 933, 938 (9th Cir. 2003) (emphasis in original). This holding conflicts with those of other circuits, which require a plaintiff to plead and prove a causal connection between the alleged fraud and a decline in the price of the stock. *See Emergent Capital*, 343 F.3d at 197 (requiring allegation connecting the alleged misrepresentations or omissions to the decline in stock price); *accord Semerenko v. Cendant Corp.*, 223 F.3d 165, 184-85 (3d Cir. 2000); *accord Robbins*, 116 F.3d at 1446, 1448-49; *accord Bastian*, 892 F.2d at 684-86.

By declining to require plaintiffs to plead the causal connection between the alleged fraud and a decline in the price of the stock, the Ninth Circuit unduly restricts the ability of the district courts to dismiss cases in which plaintiffs' losses were the result of factors other than fraud. If direct, intervening causes are eliminated from the loss causation analysis at the pleading stage – whether the intervening cause is an inherently volatile stock price, a catastrophic event that affects the overall economy, or even something more specific, like the introduction of a

competing product by another company – then there would remain no "cause" in loss causation. The Ninth Circuit itself has acknowledged that this cannot be the law: "[t]o prove loss causation, the plaintiff must demonstrate a causal connection between the deceptive acts that form the basis for the claim of securities fraud and the injury suffered by the plaintiff." *Ambassador Hotel*, 189 F.3d at 1027. Plaintiffs should be required to plead what they must prove. If they cannot so plead, then their claims should be dismissed.

2. THE NINTH CIRCUIT'S STANDARD FOR PLEADING LOSS CAUSATION UNDULY BURDENS TECHNOLOGY COMPANIES

The technology industry already faces a disproportionate amount of securities litigation – over 40% of all private securities class actions target technology companies. Perino, *supra*, at 959. The average public company faces a 9% probability over a five-year period that it will be named as a defendant in at least one securities class action lawsuit. *See* Elaine Buckberg et al., *Recent Trends in Securities Class Action Litigation*: 2003 UPDATE, BNA CLASS ACTION LITIGATION REPORT, VOL. 5, NO. 8, at 305 (April 23, 2004). Rates are substantially higher for high-technology companies. *See* PricewaterhouseCoopers, 2003 Securities Litigation Study, at 5 (August 2004), at http://www.10b5.com. In fact, private securities plaintiffs target technology companies two and a half times as often as companies in other industries. Perino, *supra*, at 961. In particular, companies in the computer services and pharmaceutical industries are at the highest risk for being sued for securities fraud. *See* PricewaterhouseCoopers, 2003 Securities Litigation Study, at 5.

The trigger for much of this litigation is a drop in the price of a company's stock. Indeed, a list of recently-filed securities class actions shows that most are filed against technology companies, that most allege violations of sections 10(b) and 20(a) and Rule 10b-5, and that most were filed quickly after a decline in stock price. *See* http://securities.stanford.edu/filings.html; *see also* Perino, *supra*, at 964 (over 50% of filings occur within three weeks of end of class period). However, stock prices for companies in the technology sector are inherently volatile. In this sector, dramatic stock price swings represent the norm rather than the exception, even in the absence of any fraud. *See* Charles M. Yablon, *A Dangerous Supplement? Longshot Claims and Private Securities Litigation*, 94 NW. U. L. REV. 777, 578-79 (2000). Technology "firms are engaged in highly competitive and dynamic industries in which products can lose their competitive advantage virtually overnight. . . . Consequently, the stock price of firms in these industries often is volatile and drops sharply because of announcements of unexpected bad news." Willard T. Carleton et al., *Securities Class Action Lawsuits: A Descriptive Study*, 38 ARIZ. L. REV. 491, 494 n.14 (1996). In the biotech industry, for example, "the fate of life sciences companies often hangs on the result of an FDA trial or scientific experiment. *See* William O. Fisher, *Key Disclosure Issues for Life Sciences Companies: FDA Product Approval, Clinical Test Results, and Government Inspections*, 8 MICH. TELECOMM. & TECH. L. REV. 115, 116 (2002).

By allowing plaintiffs who have suffered no cognizable damage to reach the discovery stage of litigation, the Ninth Circuit's pleading standard imposes substantial costs on a defendant. Regardless of a claim's merit, approximately

80% of the cost of securities litigation arises in discovery. Perino, *supra*, at 921 n.36. Such discovery costs typically approach, and can exceed, two million dollars. Joseph A. Grundfest, *Why Disimply*, 108 HARV. L. REV. 727, 742 (1994-95).

On top of the costs of discovery are the costs of settlement. Companies often calculate that settlement would be less expensive than the costs of protracted discovery; they therefore settle – not because of wrongdoing, but because of basic rational economics. James Bohn & Stephen Choi, *Fraud in the New-Issues Market: Empirical Evidence on Securities Class Actions*, 144 U. PA. L. REV. 903, 918-19 (1995-96).[3]

The majority pleading standard allows district courts to dismiss those strike suits in which plaintiffs cannot link a decline in a company's volatile stock price to any alleged fraud. By instead allowing such actions to survive a motion to dismiss, the Ninth Circuit's standard imposes an inappropriate burden on technology and other companies whose stock prices are inherently volatile.

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[3] As Professor Grundfest argues, a settlement below ten million dollars can indicate that the action was an unmeritorious strike suit. *Grundfest, supra*, at 743. Through 2003, the median settlement in securities cases was six million dollars. Laura E. Simmons & Ellen M. Ryan, *Post-Reform Act Securities Lawsuits*, CORNERSTONE RESEARCH at http://securities.stanford.edu/Settlements/REVIEW_1995-2003/2003_Settlements.pdf. Thus, by Professor Grundfest's measure, more than half of these settled cases may well have been frivolous.

3. THE NINTH CIRCUIT'S STANDARD FOR PLEADING LOSS CAUSATION CONFLICTS WITH THE EXPRESSED INTENT OF CONGRESS TO RESTRICT ABUSIVE CLASS ACTIONS

In enacting the PSLRA, Congress was particularly concerned with the burden and expense that abusive securities class actions impose on technology and other companies with volatile stock prices. *See Securities Litigation Reform Act – Veto, Hearing on H.R. 1058 before the Senate*, 141 CONG. REC. S19,146-47 (1995) (statement of Sen. D'Amato) (quoting editorial, WASHINGTON POST, Dec. 22, 1995 "This kind of suit has turned out to be a special danger to new companies, particularly high-technology ventures with volatile stock prices. The Country has a strong interest in encouraging these companies and shielding them from a style of legal assault that is not far from extortion."); SECURITIES LITIGATION REFORM, CONFERENCE REPORT, H.R. REP. 104-369 at 43 (1995) ("Technology companies – because of the volatility of their stock prices – are particularly vulnerable to securities fraud lawsuits[.]"); PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995, REPORT OF THE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS, S. REP. NO. 104-98 at 5 (1995) ("Public companies – particularly high-tech, bio-tech and other growth companies . . . are sued disproportionately in 10b-5 litigation. . . ."); 141 CONG. REC. E184 (statement of Rep. Mineta introducing *The Securities Litigation Equity Act of 1995*) (1995) (litigation costs "result in less capital for the R&D investments U.S. high-tech companies use to maintain their position at the cutting edge of the world market. For these reasons, securities litigation reform is a top priority for our Nation's high technology community.").

The PSLRA addressed these concerns by specifically requiring plaintiffs in private securities class actions to *prove* that the alleged fraud caused the losses for which plaintiffs seek to recover damages. 15 U.S.C. § 78u-4(b)(4). The Ninth Circuit's relaxed standard for *pleading* that causal connection effectively frustrates Congress's clear intent to restrict private securities actions to those cases in which plaintiffs can establish a loss arising from alleged fraud rather than extraneous factors such as the volatility of a company's stock price.

This is not merely a Ninth Circuit issue; it is a national issue. As Congress recognized in passing the PSLRA, the technology sector is vital and, without scarring the national economy, cannot remain subject to assault or extortion in the form of frivolous securities litigation. *Securities Litigation Reform Act – Veto, Hearing on H.R. 1058 before the Senate*, 141 CONG. REC. S19,146-47 (1995) (statement of Sen. D'Amato); *see also* CONFERENCE REPORT, H.R. REP. 104-369 at 31-32, 43. The PSLRA balances the interests in compensating investors for actual damages caused by actual fraud against strike suits that deter investors from capitalizing one of the United States' most dynamic, and essential economic sectors. The Ninth Circuit's pleading standard upsets that balance and is therefore contrary to Congress' intent in passing the PSLRA.

CONCLUSION

For the foregoing reasons, district courts must have the power to dismiss actions where plaintiffs cannot plead a causal link between the price of the subject company's

stock and an alleged fraud. The Ninth Circuit's standard for pleading loss causation in private securities litigation unnecessarily hinders the district courts' ability to dismiss these lawsuits and should therefore be overturned.

Respectfully submitted,

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